Germany and the Netherlands: Who Follows Whom?[1]

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8 Germany and the Netherlands: Who Follows Whom?

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8.1 Introduction

It is now time to take stock and to see how the arguments presented by the various authors can be used to answer the questions raised in Chapter 1. These questions are:

- what are the advantages and disadvantages of the Rhineland model relative to the Anglo-Saxon model for structuring the economy?
- are the changes in the Netherlands an example for the necessary changes in the Federal Republic of Germany and other Member States of the European Union?
- will the increased internationalisation and the strife for integration in Europe result in a uniform structuring of the European economies?

Section 8.2 contains a comparison of the Rhineland model and the Anglo-Saxon model in order to answer the question whether differences in the institutional settings between these two models of capitalism correlate with economic performance. One of these factors is employability. This is the employees' capability to react to changing conditions. Vocational education enhances the adaptability of employees and the receptiveness to innovation. According to Soskice et al. (Chapter 2 in this volume) wage dispersion and numerical flexibility (temporary contracts) might undercut the attractiveness to young people of investing in lower-level apprenticeships, increasing the pool of low-paid unskilled labour. Hence, there seems to be a trade-off between employability and flexibility. In our view the growing competition created by the internationalisation of economies implies that employability will become an important aspect of the competitiveness of countries. We therefore devote an entire section, Section 8.3, to the trade-off between employability and flexibility. Section 8.4 answers the question raised in the title of this book and deals with the lessons Germany and the Netherlands can learn from each other. Section 8.5 addresses the question whether there is a trend towards a uniform institutional structure of the economies in Europe. The chapter concludes with Section 8.6 on the relevancy of institutions and culture.

8.2 The Rhineland and Anglo-Saxon Model Compared

The economies of the Federal Republic of Germany and the Netherlands are examples of the *Rhineland model.* They are characterised by relatively much government involvement, a general welfare state, tripartism (cooperation) as coordinating device and long-term relationships. These countries may be viewed as consensus economies. The Rhineland model works on the assumption that institutional arrangements exist to overcome various market failures and may therefore be beneficial to national economic performance. The United States of America (USA) and the United Kingdom (UK) are variants of the *Anglo-Saxon model*, characterised by little government involvement, a residual welfare state, coordination by the market (competition) and short-term relationships. The USA and the UK may be viewed as free market economies. The Anglo-Saxon model works on the assumption that the only correction for one market imperfection is yet another market imperfection. Non-market institutions and regulations are considered causes for rigidities (Eurosclerosis). Government intervention should only occur as a last resort.

In Chapter 1 we illustrated that during the 1973-1995 period the two types of models differ with respect to the income distribution and the size of the government sector. In the Rhineland countries income is always more evenly distributed and government expenditures make up a greater part of Gross Domestic Product (GDP) than in the Anglo-Saxon countries. Based on macroeconomic criteria it is concluded that the UK performed worse than the other three countries. Relative to the Rhineland countries, the other Anglo-Saxon economy, the USA, has a slightly higher growth rate of GDP, a significantly higher employment-population ratio and a lower level of long-term unemployment. One of the two Rhineland countries outperforms the other economies under consideration related to the unemployment rate, the inflation rate and growth in unit labour costs. This description of the different aspects of the four economies also illustrates that both *the* Rhineland model and *the* Anglo-Saxon model are inadequate to typify reality. Despite similarities, the countries that are grouped in one of the two models show significant differences in both institutions and performance. Although, the Rhineland model forms the basic structure of the Dutch economy, it contains more elements of the Anglo-Saxon model than the German economy. For example, the Dutch financial system is bank-based but the stock market is much more important than the German stock markets (see Hoogduin and Huisman, Chapter 5 in this volume). The Dutch labour market is also more flexible than the German one (Schmid and Helmer, Chapter 3 in this volume). Moreover, although in both countries wage bargaining takes place at the sectoral level, there are also important differences in this bargaining process (see Chapters 2 and 4). In this section we use the results of previous chapters to assess the performance of both systems with regard to the following issues: economic growth, the efficiency of social insurance, the trade-off between equality and efficiency. The trade-off between employability and flexibility is dealt with in the next section.

The level and growth of GDP per capita are disaggregated by Schmid and Helmer (Chapter 3). GDP per capita is highest in the USA. However, the level of labour productivity (GDP per hour in 1994) is highest in the Netherlands, whereas the German and American level is of about the same size (the UK was not included in their analysis). The number of hours worked per person is lowest in the two

Rhineland countries and, moreover, declined during 1983-1994. During this period the growth in GDP per capita was almost identical in these three countries, but the increase of the number of employed (compared to total population) was higher in the Rhineland countries than in the USA. These results illustrate that in both systems GDP per capita can grow at the same level, while in the USA this is arrived by employing relatively many people and in the Rhineland countries by high productivity rates. The choice between the two depends upon the community's appreciation of leisure and the size of the social safety net. The latter is determined by the willingness of the employed to transfer part of their income to those who are temporary or permanently unable to participate in the working process. The degree of solidarity is in its turn a reflection of the importance of collectivism in the society's values (see Section 8.6).

The share of public social expenditures is higher in the European countries (including the UK) than in the USA. However, in Chapter 4 Van de Meerendonk showed that these differences disappear if account is taken of private social expenditures. Total social expenditures appear to be of the same level in the UK, the USA and the Netherlands, whereas the number is slightly higher in Germany (Table 4.10). In general the social benefit payments in the Rhineland countries are higher than in the UK and the USA (Table 4.11). The same conclusion can be drawn concerning the replacement rates of employment benefits (Table 4.12).

Okun has postulated a trade-off between equality and efficiency. According to Okun (1975, p. 1) inequalities in living standard and material wealth "reflect a system of rewards and penalties that is intended to encourage efficiency and channel it into socially productive activity. To the extent that the system succeeds, it generates an efficient society. But that pursuit of efficiency necessarily creates inequalities. And hence, society faces a trade-off between equality and efficiency". Van de Meerendonk (Chapter 4 in this volume) illustrates that during the last decade in the Anglo-Saxon countries the dispersion in earnings has increased, whereas in the Rhineland countries it has remained at approximately the same level (Table 4.16). Even more important is that for German low-paid workers the probability to move to a higher level of income is greater than for their American counterparts (Table 4.17). Moreover in the European countries (Germany, Netherlands and UK) the social security systems contribute significantly more to the elimination of poverty than that in the USA (Table 4.18). Given the fact that the total amount of expenses on social security (as a percentage of GDP) are of approximately the same size this implies that the European systems are more efficient in reducing poverty. Hence income is most unequally distributed in the Anglo-Saxon countries, but these countries do not systematically outperform Germany and the Netherlands on efficiency criteria such as the GDP per capita and the efficiency of the social security system. These results suggest that for the industrialised countries the trade-off between equality and efficiency is rather flat.

8.3 The Employability-Flexibility Trade-Off

The growing competition created by the internationalisation of economies and the expanding European Union (EU) implies that international differences in the patterns of employment and unemployment increasingly depend on the capacity of national economies to innovate and to absorb new technology. *Human capital* will become more important in explaining international trade (Baily et al. 1993; Porter 1990). Human capital is beyond skills and knowledge. It also refers to people's ability to work together for a common purpose (social capital). The latter depends on trust. Only those societies with a high degree of social trust will be able to create the flexible, large-scale business organisations that are needed to compete in the new global economy (Fukujama 1996, p. 10). Recent research results support Fukujama's 1996 argument that trust facilitates all large-scale activities, not just those of the government (see La Porta et al. 1997).

Accessible education is of importance, certainly for open economies that become more influenced by international competition. There is an increasing awareness that human capital in technology driven economies becomes a decisive factor in contributing to economic performance. In the 1990 report *Labour Market Policies for the 1990s*, the OECD concludes that the emerging `skill gap' not only results from future demographic developments and technological trends, but also from the maladjustment of the education and training system to the world of work. Forecasting skill needs are unreliable. This puts a premium on flexibility. The key objective must be to impart to all young people a broad base of transferable skills. Both schools and employers are responsible. For adults, the private sector must assume primary responsibility for the provision of training and retraining opportunities (OECD 1990, p. 64). By expanding training opportunities for employed workers, and, hence, making them more employable both elsewhere in their current firm and in other firms, and by easing the consequences of job loss (through training or through the labour market exchange) the stage can be set for more flexible and hence more productive employment systems.

The present flexibilisation and deregulation trends, will be intensified by the European Economic and Monetary Union (EMU), resulting in higher mobility, a growing number of flexible jobs and more *insecurity.* These developments may be detrimental to the necessary investment in human capital by employers and employees. The flexibilisation is accompanied by a decentralisation of industrial relations. Also the latter may be detrimental to investments in human capital for a number of reasons. Despite the fact that individual employers are convinced of the importance of investment in human capital and better industrial relations, actions towards these goals will not be achieved, because they are trapped in a *prisoners dilemma.* Investment in human capital not only has positive internal effects, but also has considerable external effects. In the short-term, however, it puts the individual employer in a cost disadvantage relative to its competitors. The prisoners dilemma and the related *free-rider problem* can only be avoided by agreements at national or sectoral level. Also the administrative extension, that make collective agreements generally binding, like in Germany and the Netherlands, is an answer to this free-rider problem. Moreover, as has been shown in the previous Chapters 2 and 4, the wage determination has an important relationship with the training system. The consensus economies are in a favourable position in this respect. Collective agreements facilitate schooling and other skill-upgrading arrangements. Centralised collective agreements offer the opportunity to the trade unions to make a swap between wages and training or other issues, like employment and working conditions, affirmative action, child care, prevention of sick leave, employment of minorities, etc.. Hence, wage moderation is more easy to achieve at the central level, compared with decentralised bargaining. When trade unions take part in economic governance they will be less inclined to rent-seeking behaviour than trade unions in free market economies. In the latter case insiders' interests will prevail. Decentralised wage negotiations at the establishment level may result in a *hold-up problem*. Players retain their specific investment since they expect that future bargaining on the distribution of the surplus due to specific investments, will deprive them of part of the returns. This hold-up problem may be avoided by sectoral negotiations as is the case in Germany and the Netherlands and provide a type of flexibility that is not available in decentralised economies like the USA and the UK, where the enterprise is the dominant level (see also Teulings 1997).

From this and the previous section we conclude that none of the two models of capitalism always dominates the other. Both system can generate the same growth rates. A more equal income distribution does not lead to less efficiency. The way each of the two models arrive at these results differs and, as will briefly discussed in Section 8.5, depends upon the society's values. There are signs that due to its high degree of flexibility, the Anglo-Saxon model performance better than the Rhineland model during periods of structural changes. As the discussion in this section reveals care should be taken that the flexibility does not harm the employability and in this way prospects of long-term growth.

8.4 Are the Netherlands an Example for Germany?

8.4.1 Introduction

During almost the entire post-World War II period, the economic system of the Federal Republic of Germany was regarded as the role model for many European countries. For example, the low inflation reputation of the Bundesbank has been an argument for the members of the Exchange Rate Mechanism of the European Monetary System to peg their currency to the Deutschmark. The Netherlands can be regarded as the country that in the most strict sense has implemented this strategy of following the German monetary policy (see Chapter 5 by Hoogduin and Huisman and Chapter 6 by Jochimsen). The Dutch competition policy is another field of economic policy in which the Netherlands follows Germany as Gradus showed in Chapter 7.

The recent admiration for the strong employment growth delivered by the Dutch Delta model raises the question whether we have come to a point in time at which the roles will be or should be reversed: Germany follows the Netherlands instead of the opposite. With a view to answer this question we briefly describe the political measures, Section 8.4.2, and external circumstances, Section 8.4.3, which are responsible for this Dutch success. In Section 8.4.5 we put some critical remarks to the main elements of the Dutch employment miracle. Finally, in Section 8.4.6 we answer the question whether Germany should and could follow the Dutch example.

8.4.2 Political Measures

Wage moderation is an important explanation for the strong employment growth in the Netherlands since 1982. In the 1980s, average real wage increases in the Netherlands were below average productivity increases, resulting in additional jobs for over 400,000 persons (CPB 1991). At the same time the Dutch guilder appreciated. As came forward from previous Chapters 2 and 4, in the Netherlands the *profitability* of the manufacturing sector increased significantly, while the German manufacturing firms had to lower their prices in order to maintain their international market share. German profitability rates declined. For the greater part of the period concerned, the effective exchange rate of the guilder appreciated. The direct effect of this appreciation could be a drop of the profits margins. However, in the Netherlands the negative influence of the appreciation of the currency was overcompensated by the real wage moderation, so that on balance the profits could rise. On the other hand the appreciation of the Deutschmark was at the expense of the Germany's competitiveness (see Van Riel and Metten 1996; *European Economy* 1996, 61).

The wage moderation in the Netherlands was supported by the disengagement of the coupling mechanism and tax relief. The latter consisted of a general tax relief policy and selective tax reductions at the lower end of the labour market, in order to promote employment. These measures reduced the wedge end thus enabled the trade unions to support and prolong the moderate-wage policy. The tax relief was made possible by the success of the fiscal consolidation that started in 1982. At that time the Dutch fiscal deficit was at its maximum (6.9% of GDP) (CPB 1994, p. 180) and the debt to GDP ratio was increasing fastly. In the Netherlands the *reform of the social security system*, has laid a solid base for fiscal policy consolidation, as Van de Meerendonk has pointed out in Chapter 4.

The *fiscal consolidation* also created room for additional expenditures in the 1990s, in particular for subsidies to employ people who are unemployed for a long period (`Melkert-jobs'). Finally, the budget came under control, which was a sign for the financial market that the Dutch government was willing and able to take disagreeable measures, if necessary. In this way the budgettary policy supported the central bank's monetary policy.

The central element of the Dutch monetary policy has been to peg the Dutch guilder to the Deutschmark (see Jochimsen, Chapter 6 in this volume). The ultimate aim of this policy is to create a low and stable level of inflation and thus a low level of the long-term interest rate. As will be shown in Section 8.4.3, this low level of the interest rate has been instrumental in increasing consumption in last years.

Finally, *deregulation and privatisation* have been another important element of Dutch policy during the last decade. Gradus (Chapter 7) described the main changes in competition policy in the Federal Republic of Germany and the Netherlands. Both Germany and the Netherlands are changing their legislation to bring it into line with EU law (see OECD 1996a, pp. 61-66; OECD 1996b, p. 137) The results of empirical research on the impact of deregulation of product markets are contradictory. For instance, Nickell 1996 found for a large number of enterprises in the UK a positive relationship between competition and productivity growth. Other research shows that Rhineland enterprises outperform Anglo-Saxon enterprises (De Jong 1996). These contradictory conclusions illustrate the difficulty to estimate the influence of (de)regulation on the economy. Moreover, a number of deregulation measures in the Netherlands, like the Shop Opening Hours Act, the Competition Law and the liberalised Establishment Law are too recent to have any measurable effect. That is why the alleged Dutch employment miracle cannot be explained from more product market functioning, although it may be that on balance the effects are positive for employment.

8.4.3 Favourable External Circumstances

A disadvantage of moderate wage increases is that it reduces domestic demand. This drop in demand did not occur in the Netherlands because of a number of favourable external circumstances (see Delsen and De Jong 1997). In the second half of the 1980s, the Netherlands profited from the synchronous development of the economic situation in the industrial countries. At the beginning of the 1990s, the United States and the United Kingdom ended up in a recession, while in Germany expenditure increased, related to the construction of former East Germany. Within the European

Union, the Netherlands, Belgium and Luxembourg benefited most from the *German unification*. Calculations by the European Commission (1992, p. 8) show that both for the Netherlands and the Belgian-Luxembourger Economic Union (BLEU) the German unification resulted in an additional growth of 1.6% over the period mid-1990 to end-1991. For the other EU-Member States (Germany not included) the calculated impulse was 0.6%.

In the following years also continental Europe was hit by a recession, and once again the Netherlands were an exception to the rule. In 1993, the Dutch GDP still increased slightly by 0.3%, while on average for Western European GDP dropped by 0.5% (CPB 1994, pp. 13 and 15). During this recession and in the first part of the recovery (1994 and 1995), the Netherlands benefited from their *specialisation package*. This package is strongly directed at the agricultural sector and related activities (the agro-industrial complex) and at the chemical sector (see CPB 1993). The demand for agricultural products is relatively insensitive to the business cycle. The demand for chemical industry products and other semi-manufactured articles is high at the beginning of the upturn of the business cycle, when stocks have to be replenished. In 1994 and 1995, Dutch industry benefited from this. As the economic situation ripens the Dutch specialisation pattern becomes more unfavourable. The demand becomes more concentrated on investment goods and durable consumption goods, sectors in which the Netherlands are not specialised.

Table 8.1 Average mortgage interest and houses completed/sold in the Netherlands, 1993-1996

Year	Average mortgage interest (percentages)	New mortgages[1] x 1000	Houses completed/sold (a) x 1000	(b) x 1000	(c) x 1000
1993	7,50	339	140	76	84
1994	7,26	431	166	78	87
1995	7,12	406	178	85	94
1996	6,25	563	179	90	89

(a) Total (a) = (b) + (c).
(b) Transactions of all houses sold.
(c) Delivered new estate of houses.
[1] Number of new mortgages on houses (including combinations house/business premises).
Source: Statistics Netherlands (CBS) and Dutch Association of Real Estate Agents (NVM) (transactions of all houses sold).

When in 1996, the Dutch specialisation pattern turned against the Netherlands, it was the low interest rate that came to the rescue. In 1996 the low *interest rate* resulted in a strong increase in consumptive credits and a growth in the number of mortgages. In the second half of 1996, the outstanding amount of consumptive credit increased by 890 million guilders to almost 23.5 billion guilders. Never before in a six months period, the outstanding amount of consumptive credit increased that much (see CBS 1997). Moreover, in the past years the number of contracted mortgage loans increased much more than the number of sales of existent houses and new buildings (see Table 8.1). This suggests that part of the new mortgages has been used to recontract existing mortgages or to finance consumptive expenditures. CPB (1997, p. 67) estimates the real capital gains from the increase of prices of houses at 50 billion guilders. Probably around 10% of this gain will result in higher consumptive spending. The impact of the appreciation of shares is probably much less. Both developments may explain the increased confidence of consumers and the relative high growth of household's consumption, notably of durable goods. In 1996, the volume of the latter increased by 4.25%.

8.4.4 A Dutch Employment Miracle?

The *Dutch job-machine* seems to be working at full speed. The unemployment rate is low, which is a result of the high growth rate of employment. However, the level of the latter still is relatively low. Another positive characteristic of the Dutch labour market is its high level of labour productivity; in 1994 the Dutch level of GDP per hour worked was around 9% above that in Germany, 10% above that in the USA and around 22% above the EU average (see Schmid and Helmer, Table 3.2, Chapter 3 in this volume; OECD 1996a, p. 77).[2] Apart from quantity also quality matters. Between 1987 and 1994 two thirds of Dutch employment growth was in part-time jobs. Between 1994 and 1996 employment growth accelerated. Almost 40% of the recent employment growth was in flexible jobs; 60% of the jobs growth was in small part-time jobs (< 12 hours) and flexible jobs (fixed-term, on-call and agency work).[3] This may explain why in the Netherlands, the proportion of involuntary part-timers is higher than in Germany (see also Schmid and Helmer, Chapter 3 in this volume). However, in the Netherlands the growth of part-time employment and of temporary jobs is mainly, and even more than in other European countries, supply-side driven; relative to other EU countries in the Netherlands a large number of employees prefer a part-time job (see Delsen 1995). Considerable proportions of Dutch working men and women want to reduce working hours at the same hourly wage rate. It is stimulated by change in cultural impediments and reduction in prejudice. There is a growing consensus between the social partners on the value of part-time

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[2]The growth rate of the Dutch labour productivity is relatively low, so that the level converges towards the lower level of other countries.

[3]These percentages are calculated from Statistics Netherlands (CBS) data. For 1996 only data up to the second quarter are included.

employment (see Delsen 1997).

The disadvantages of the high share of part-time and flexible contracts can be distinguished into two groups: short-term and structural problems. The *short-term problem* is that the Dutch employment miracle may turn out to be an unstable one. These marginal jobs are very sensitive to the business cycle; a turn in this cycle implies that the Netherlands will immediately – and more than other EU-Member States – be confronted with considerable lay-offs and increasing unemployment figures.

Apart from this short-term impact, flexibilisation of the labour market also causes a number of *structural problems*. One may question whether wage moderation and more deregulated labour markets are a solution to the labour market problems at the lower level. The growth of small part-time jobs and flexible jobs may result in poverty when no additional income at the individual or household level is available. Although employment has increased considerably, the volume of work in hours has remained relatively constant. There has been a massive redistribution of work, with a corresponding redistribution of earnings (see Schmid and Helmer, Chapter 3 in this volume). Moreover, there is the real danger of segmentation not only between incumbent workers, the insiders, and the unemployed, but also between the insiders: a segmentation both of the external and internal labour markets (see Delsen and De Jong 1997). Another structural problem occurs because the growth of temporary jobs will affect the *social infrastructure*. The latter may be a threat to durable economic growth (Van Dijk 1997). These flexible jobs may also negatively affect investments in human capital by employers and employees. An active labour market policy can be a solution to at least part of these problems. However, as Schmid and Helmer showed, in the Netherlands and Germany the expenses for active labour market policy are relatively low.

As came forward from previous Chapters 3 and 4, the relatively high labour productivity in the Netherlands is partly due to *exclusion* – more than in any other EU countries and the USA – of those employees with relatively low productivity, for instance disabled persons through disability benefits and older workers through various generous early exit options from the labour market, including early retirement, disability for labour market reasons (see also Delsen and Reday-Mulvey 1996).[4] As a consequence, the number of employed is relatively low. This may cause problems for financing the government budget and the social insurance.

8.4.5 Should Germany Follow the Dutch Example?

[4] It should be noted, however, that other institutions also matter as came forward from Van de Meerendonk's Chapter 4 in this volume. The social climate in the Netherlands is good relative to Germany and certainly relative to the UK and the USA: stable and peaceful system of industrial relations and relatively few days are lost by strikes, resulting in employees' commitment to the result of a firm and a good basis for business training, contributing to productivity.

Now time has come to investigate whether the Federal Republic of Germany should and can follow the Dutch example. In Section 8.4.3. we argued that part of the Dutch success can be ascribed to good luck. In fact the major part of this luck is that the most important neighbour of the Netherlands, Germany, during some time has followed an expansionary policy, which had its favourable spinoffs for the neighbouring countries. Of course chances are low that Germany will ever have a comparable luck. In discussing the other relevant issues we follow the sequence of the Sections 8.4.2 and 8.4.4.

Wage moderation forms the essential element of the Dutch model. Can Germany generate a wage constraint of a comparable size? With a view toward answering this question, a closer look at the wage bargaining process in both countries is useful. Both the Netherlands and Germany are characterised by sectoral wage negotiations. However, there are considerable differences between these two countries, as Soskice et al. and Van de Meerendonk showed in Chapter 2 and Chapter 4. In the Netherlands more negotiations take place at the central level, and more than in Germany informal coordination takes place of the sectoral level negotiations by trade unions and employers' organisations or by the tripartite Socio-Economic Council. Moreover, in the Netherlands the social partners consult more frequently at the central level in the so-called Foundation of Labour. This limits the influence of the insiders and may explain why wage moderation has a long history in the Netherlands, unlike in Germany. In Germany that coordination is less overt. Moreover, there are cultural differences. The German industrial relation system is characterised by *Tarifautonomie*, while in the Netherlands government involvement in the wage formation process is common. The Netherlands can be characterised, more than Germany, by a *consensus economy*. The latter may be a reason why the January 1996 tripartite `Bündnis für Arbeit' already is a failure, while the 1982 Central Agreement to reduce unemployment in the Netherlands has been and still is a success. Taking into account these cultural difference it may be questioned whether the overall understanding to negotiate a wage restraint in Germany, recommended by Soskice et al. (Chapter 2) as a cure for the German unemployment problem, may in fact be feasible. The German federal government finds more difficulties in exerting political power than the Dutch, and it may be more difficult for the German government to commit the corporatist parties into a comprehensive policy framework.

Even if the German social partners could agree upon a policy of moderate wage increases during several years, one can argue that the favourable effects are likely to be smaller than in the Dutch case. The arguments for this proposition refer to the differences in size and industrial structure of the two economies. Germany is the dominant economy of the European Union. This implies that chances are high that a policy of wage moderation will be followed by neighbouring countries, so that a *vicious deflationary policy* is set into motion in Europe. Moreover due to the size of the economy, the German export sector makes up a smaller part of GDP and employment than that of the Netherlands. As a result a wage moderation in Germany will almost surely lead to a fall in domestic (and European) demand, so that the favourable effects on employment will be lower than they would have been in the case of the Netherlands. In some sense one can say that the Netherlands have exploited their position of a small open economy. Or in other words, a policy of wage moderation is a beggar-thy-neighbour policy.

As has been put forward by Soskice et al. the share of the services sector in GDP is higher in the Netherlands than in Germany. Services require more low skilled and low paid workers than the industry. Moreover, the German industrial sector follows a *high quality incremental innovation strategy*. The Dutch experience shows that wage moderation has a negative impact on productivity. Wage moderation relieves the pressure on firms to motivate and give workers little incentive to acquire new skills (see for instance Kleinknecht 1996). Productivity growth in the Netherlands is very modest. The latter may be at the expense of future employment growth and competitiveness. According to neoclassical economic thinking low productivity leads to low compensation. However, this causality can also run in the opposite direction: access to labour at low compensation makes the search for productivity increases unnecessary for the employers, and thus undermines the high quality incremental innovation strategy of the German industry.

Hence a policy of wage restraint, if implemented, should be supplemented by other measures in order to be effective for reducing unemployment. Possible candidates are wage differentials, part-time jobs, liberalisation of product markets and fiscal consolidation. Van de Meerendonk pointed out in Chapter 4 that, unlike in the UK and the USA, allowing for more *wage dispersion* may well be an effective solution to the high share of low-skilled unemployed in Germany and the Netherlands, because these countries have well-functioning systems of vocational and company training. Soskice et al. (Chapter 2) are much more sceptical. They think that it "might undercut the attractiveness to young people of investing in lower-level apprenticeships, thus increasing the pool of low-paid unskilled labour" (p. 50). We are of the opinion that these negative effects can be circumvented by including compulsory measures for improving skills in wage agreements and in the conditions for obtaining unemployment benefits. Hence, as Van de Meerendonk, we plea for wage dispersion. Moreover modest wage increases in labour intensive sectors, such as services, can be instrumental in boosting these sectors and thus increasing their share in German GDP and employment. Such a switch may be advantages given the increasing demand for services. The effects of the German reunification also deliver an argument for wage dispersion. As a consequence of the unification there was a massive wave of migration from the East to the West. Unions, employers and government agreed on a national plan for the transition of East German wages to West German wages. In addition a huge fiscal transfer scheme and a special income tax supplement (solidarity contribution of 7.5% in 1995) were put in operation to reduce migration. However, the equalisation of real wages across Germany poses a danger. Such convergence would cause high unemployment, lasting for decades (see Brakman and Garretsen 1997). On the other hand wage discipline needed to reduce the eastern unemployment rate to the western level would require a widening of the wedge between wages in the two regions for an extensive period and either route increases the potential for migration. One possible response would be to seek a compromise between convergence of unemployment and convergence of wages (see Hughes-Hallett et al. 1996).

Although disadvantages are associated with part-time and temporary jobs (see Section 8.4.4), these types of jobs are effective in reducing unemployment and increasing the employment to population ratio. Whether the number of these *atypical jobs* can be increased substantially in Germany, not only depends upon the attitude of German employees but, as the Dutch experience shows, also on a consensus between government and social partners on the advantages of part-time work. Bringing about such a consensus takes time.[5]

Regulation of markets can improve the efficient functioning of the market economy. In fact no market economy can function appropriately without rules. Too much regulation, however, will constrain economic activity. The level of regulation in Germany and the Netherlands are of the same magnitude (see Figure 7.1 in Chapter 7). In Section 8.4.2 we concluded that although it is difficult to measure the effect of deregulation, it might be that in the Netherlands this policy has enhanced employment. Assuming that this conclusion correct, we are of the opinion that a *deliberate deregulation* and privatisation policy can be recommended for Germany as well.

Fiscal consolidation can have various favourable effects. First, if part of it consists of a reduction of taxes and premiums, the willingness of trade unions to accept modest wage increases and the costs of the firms decrease and thus their profits increase. The reduction of taxes is also needed for financing the pensions in the future. In Germany the majority of *pensions* is on a pay-as-you-go system. Given this system, the ageing of the population implies a sharp increase in expenditures, which have to be paid by a steadily decreasing number of people of working age. A restructuring is needed of the German pension system towards the Dutch system, where a large part of the pensions are financed by funds.

In conclusion, the German problems cannot be solved by simply following the Dutch example. The structure of the German industry and the dominant role of Germany in Europe make that a policy of moderate wage increases is expected to be less effective than it has been in the Netherlands. Other measures taken by the Dutch authorities maybe more worthwhile. Examples are: wage dispersion, part-time contracts, a modest liberalisation and fiscal consolidation. On the other hand, in our view the German system of vocational training serves as an example for the Netherlands. Implementing a similar system in the Netherlands can improve the employability of the Dutch employees. Maybe we have left the era of leaders and followers behind us and time has come for walking hand by hand. As argued by Jochimsen in Chapter 6, the creation of the Economic and Monetary Union urges for a cooperative behaviour.

8.5 Lessons for the European Union

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[5] The first initiatives of the Dutch government to actively promote part-time work date from the end of the 1970s. This illustrates the path dependency and the importance of governments in changing attitudes and culture as well as policies.

Within the European Union there are considerable differences in institutional structures between countries. In fact the economies of members of the EU can be categorised in at least three models: the Anglo-Saxon model, the Rhineland model and the Latin model. This large variance is also found in studies on *cultural values* in different countries. It appears that the differences between the European countries are almost as great as those between countries all over the world (see Hofstede 1993). Previous chapters clearly showed that due to the internationalisation and the common market policy, over the past decades the *institutional structure* of the labour markets, the markets for goods and services as well as the financial markets in Europe has shifted towards the Anglo-Saxon model, i.e. a shift from non-market coordination towards market coordination. This raises the question: will the increased internationalisation and the strife for integration in Europe result in a uniform structure of the economy, i.e. in one European model? Since the previous chapters did not analyse the Latin model we restrict the present discussion to the Rhineland and Anglo-Saxon model.

This change to incorporate more Anglo-Saxon features in the economic system showed itself in a policy of flexibilisation, deregulation, decentralisation and privatisation and was mainly motivated by cost containment and desired flexibility to cope with the internationalisation of the economies and the accompanied increased competition from foreign countries. The increased importance of Anglo-Saxon features also implies a shift from long-term aims towards aiming at short-term results. Increased wage flexibility and improvement of the workings of labour markets by means of institutional changes are indeed advantageous in the short-run, however, they are detrimental to commitment, to the willingness of workers to adapt to technological change and discourage innovation, as has been argued by Soskice et al. in Chapter 2 (see also Kleinknecht 1996). Limitations on flexibility offer the needed stability; they not only involve costs, as supposed by neoclassical economics, but also increase productivity and adaptability. Since a high level of commitment is typical for the Rhineland model and flexibility for the Anglo-Saxon model, we are of the opinion that a particular system of capitalism does not dominate the other systems every time and everywhere.

Not every time, because the preference for an economic system depends upon the *specific economic environment*. In general, due the relatively high level of committment, the Rhineland model works well in a stable economic environment. Consultation leads to an improvement of the quality of the products and processes. The fact that consultation takes time is then relatively unimportant. During periods of structural change, consultation can pospone necessary adjustments. Then, the flexibility of the Anglo-Saxon model is needed.

A particular economic system will not dominate the others *everywhere*, because the characteristics of a country's economic institutions incorporate the *values* of that society. For example, a study of cultural values reveals that German people put more weight to uncertainty avoidance and collectivism than the inhabitants in the Anglo-Saxon countries do. On both items the score for the Netherlands is in the middle (see Hofstede 1982, pp. 122 and 158). Another more recent study of the managers' aims in these three countries concludes that in the USA the managers are – more than their counterparts in the Netherlands and Germany – forced to deliver short-term growth of earnings per share (Weimer 1995, p. 339). These values are the results of historical processes which last for centuries instead of decades or years.[6] It is unlikely that such long-lasting processes will change dramatically in a few years. The challenge of each society is to adapt its economic system to the needs of the present economic environment. Elements of another system might be useful, however, "societies should be fully aware of the positive and negative aspects of implementation of such alien elements" (Groenewegen 1997, p. 343).

From the previous paragraphs we conclude that, although the structural changes force adaptations of each system, basically the present variety of economic systems will remain in Europe. Since each model has its own merits, this diversity can be regarded an asset for Europe, in the sense that for every economic circumstance there is always a national model that is fit for handling the corresponding challenges. This raises the question whether within Europe these models should compete with each other or that there is a need for co-ordination at the European level. We plead for a "coordinated" competition, i.e. competition forms the basis but is supplemented by European agreements which restrict it. Competition is good since it forces each society to adjust its institutions to changing circumstances. However, since no form of capitalism dominates the others in all circumstances, coordination is needed in order to assure that this competition is not too aggressive. Aggressive competition (subsidies, tax credits etc.) might give rise to retaliation or might destroy the institutional structure of another country. Both results destroy the advantages of Europe's cultural diversity.

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[6] Pott-Buter, for example, concludes from a comparative study of female labour participation rates in seven countries, that the relative low participation rates of Dutch females during the last century can be explained by the view on the family household as this came into existence in the Dutch Golden Age. At that time the family relationships of the rich bourgeois middle income classes became the dominant form of household behaviour. Underlying this model was that "the well-being of all the members of a household was improved if men provided the financial resources and companionship and women were responsible for raising or maintaining the quality of life of the household This quality-oriented family model gave women working in their own households a higher status..." (Pott-Buter 1993, p. 48), and resulted in a low female participation in the labour market.

8.6 Institutions and Culture Matter

Social capital is like a ratchet that is more easily turned in one direction than another; it can be dissipated by the actions of governments much more readily than those governments can build it up again (Fukuyama 1996, p. 362). Trust or social capital determines the performance of a society's institutions. Trust my not be truly exogenous; it may increase with good past performance of a society's institutions (see La Porta et al. 1997). The stable or self-enforcing systems of norms are a starting point for the explanation of institutional differences between countries. Deregulation may be at the expense of trust and commitment, or in general the social climate (trust, values and norms), the latter being a major source for good economic performance. It is the latter that has often been excluded from economic analyses and overlooked by policy makers in reshaping welfare states (Nyfer 1996). There is a strong cultural element in the way market institutions operate. Economic institutions are for their effectiveness and legitimacy dependent on other institutions and cultural values present in societies (Van Waarden 1997, p. 13). Once the regime is changed because it temporary cannot be sustained, the assumption on which it is based will be eroded, and it will be very difficult to re-establish the regime again (see Layard 1997). Thus in case an economy is performing badly, it may be wise to look at a country with a similar instead of a very different institutional structure and cultural background for obtaining ideas for improving the economy.

Since the German and Dutch economy are both variants of the Rhineland model, this book concentrated on a comparison between the institutional and economic structure of these two countries in order to investigate whether their institutions can be improved. Changes in institutional structure may be necessary given the challenges implied by internationalisation, new technologies, EMU, and demographic aging. In order to put this comparison into a broader perspective, the United Kingdom and the United States of America, representatives of the Anglo-Saxon model, have been used as benchmarks. It appeared that the Rhineland and Anglo-Saxon countries systematically differ from each other with respect to the income distribution and the size of the government sector; in the Anglo-Saxon countries income is always more unevenly distributed and government expenditures are always smaller than in the Rhineland countries. These differences correspond with the prominent place of the individual in the Anglo-Saxon societies (see e.g. Hofstede, 1982, Figure 5.2, p. 158). In the Rhineland countries, especially in Germany, the collectivity is more important.

Since the beginning of the 1990s the Dutch economy is outperforming the economies of other European countries. These results are obtained by a particular mixture of individualistic and collective features of the Dutch society. On the one hand measures have been taken which have increased the responsibility of the individuals and firms for their actions. Examples are the reform of the laws on sickness and disability benefits. Of even more importance (at least for reducing the unemployment) is maybe that many have accepted temporary and part-time labour contracts. On the other hand the core of the Dutch success, wage moderation, is the result of the consensus society. Soskice et al. argue that the structure of the industry and of the wage bargaining process in Germany differ so much from those in the Netherlands that copying the successful Dutch policies would be impossible. Although the two economies belong both to the Rhineland model, the cultural differences are in their view too large. If this is true than the same argument could be applied even more forcefully to other countries in Europe (such as France and Italy). In our opinion it is correct that culture and differences in institutional arrangements matter for economic policy. The differences between countries in this respect along with other factors, such as size and specialisation, imply that policies which are successful in one country need not be the appropriate policies for other countries, even if from a broader perspective these belong to the same model of the market system. Institutions have both advantages and disadvantages. This urges caution in relation to liberalisation initiatives in Europe. However, although cultural differences are important they should never be used as an excuse for delaying necessary adjustments.

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